U.S. Senate
Republican Policy
Committee

Larry E. Craig, Chairman
Jade West, Staff Director
No. 86

Legislative Notice

Editor, Judy Gorman Prinkey

July 23, 1998

H.R. 1151— Credit Union Membership Access Act

Calendar No. 384

Reported May 21, 1998, by the Senate Committee on Banking, Housing, and Urban Affairs, with an amendment in the nature of a substitute, by a vote of 16-2 (Senators Mack and Hagel voting nay). S. Rept. 105-193, additional views filed.

NOTEWORTHY

- H.R. 1151 is anticipated to be considered without a unanimous consent agreement.
- H.R. 1151 addresses the Supreme Court decision in *National Credit Union Administration v. First National Bank and Trust Co., et al.*, 1118 S. Ct. 927 (1998), which found that federal credit unions could not consist of more than one occupational group having a single common bond. The House passed its version of H.R. 1151 on April 1, 1998, by a vote of 411-8.
- The bill amends the Federal Credit Union Act to preserves all existing multiple bond arrangements, while limiting the growth of future multiple bond credit unions to groups of less than 3,000 members.
- The banking industry — in particular, smaller, independent banks — has expressed concern that credit unions have outgrown their founding principles and are now providing services, such as business loans, that make them more like banks. The bankers claim that credit unions no longer deserve the competitive advantages of federal tax exemptions and less-stringent regulatory procedures.
- Others concerns raised are that increased business loans by credit unions could potentially increase the risk of taxpayer losses to the National Credit Union Share Insurance Fund and present safety and soundness concerns for credit unions.
- In response to the bank competition and taxpayer concerns, the bill caps the total amount of business loans made by a credit union at any one time. The total amount of member business loans could not exceed 12.25 percent of the total assets of the credit union. And, the bill subjects credit unions to capital requirements and a system of prompt corrective action to promote safe and sound credit unions.

BACKGROUND

On February 25, 1998, the Supreme Court ruled in *National Credit Union Administration v. First National Bank & Trust Col, et al.*, 1118 S. Ct. 927, that federal credit unions may not consist of more than one occupational group having a single common bond. The case is based on the National Credit Union Administration's (NCUA) interpretation of section 109 of the Federal Credit Union Act. Section 109 provides that "federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district." Since 1982, the NCUA has interpreted section 109 to permit federal credit unions to be composed of multiple unrelated employer groups, each having its own common bond of occupation. According to the Congressional Research Service, this policy change "has resulted in large, interstate, credit unions that now offer banks competition for consumer products and services" [CRS Report 98-162A]. Five banks and the American Bankers Association challenged the NCUA's interpretation claiming it was impermissible. The Supreme Court agreed, finding that the NCUA's interpretation was "contrary to the unambiguously expressed intent of Congress that the same common bond of occupation must unite each member of an occupationally defined credit union."

The House of Representatives, concerned that the Supreme court ruling could result in an injunction of the admission of members who do not share the original single common bond of occupation, passed H.R. 1151 on April 1, 1998, by a vote of 411-8. That bill was referred to the Senate Banking Committee, which held a series of hearings, and marked up a bill on April 30, 1998. The bill was reported out of committee by a vote of 16-2, with Senators Mack and Hagel voting against the motion to report the bill from Committee.

H.R. 1151 addresses the Supreme Court decision by preserving all existing multiple bond arrangements, while limiting the growth of future multiple bond credit unions.

BILL PROVISIONS

Sec. 1. Short Title; Table of Contents

Sec. 2. Findings

Sec. 3. Definitions

Title I— Credit Union Membership

Sec. 101. Fields of Membership

- The legislation establishes three types of common bond membership categories for federal credit unions:

- (1) *single common-bond* — one group that has a single common bond of occupation or association;

- (2) *multiple common-bond* — more than one group, each of which has a common bond of occupation or association that does not exceed 3,000 persons *at the time* the group is included in the field of membership (this designation responds to the Supreme Court decision regarding common bond in *National Credit Union Administration v. First National Bank & Trust Co., et al* (1998)); and

- (3) *community credit unions* — persons or organizations within a well-defined local community, neighborhood, or rural district.

- This section grandfathers any person or organization that is a member of any federal credit union as of the date of enactment of the Act, and any individual member of a group that is part of a credit union remains eligible to become a member.

- A further exception is made for persons or organizations within a local community, neighborhood, or rural district that is under-served by other depository institutions. These persons or organizations are allowed to join an existing credit union if the credit union establishes a service facility in the area.

- Membership eligibility is extended only to members of an " immediate family or household" of a credit union member. However, once a member joins a credit union, that person may remain a member until he/she chooses to withdraw.

Sec. 102. Criteria for approval of expansion of membership of multiple common-bond credit unions

- The NCUA is required to encourage the formation of separately chartered credit unions rather than including an additional group within an existing credit union. If a separate group is not practicable, then the inclusion of the group is required to be in a field of membership of a credit union that is within reasonable proximity to the location of the group.

- Any time a credit union chooses to add a new group to its field of membership, it must apply to the NCUA. The NCUA must then find that the credit union has met a number of criteria, including adequate capitalization and that the credit union has not engaged in any unsafe or unsound practice.

Sec. 103. Geographical guidelines for community credit unions

- Requires the NCUA to promulgate regulations defining "well-defined local community, neighborhood, or rural district."

Title II— Regulation of Credit Unions

Sec. 201. Financial statement and audit requirements

- Requires credit unions with assets of more than $10 million to file reports or statements that are uniform and consistent with generally accepted accounting principals.

- Credit unions with assets greater than $500 million are required to have an annual independent audit performed by a certified public accountant.

- Credit unions with assets greater than $10 million but less than $500 million, who choose to voluntarily conduct an audit using an independent auditor who is compensated for his/her audit services, must follow appropriate State accountancy laws.

Sec. 202. Conversion of insured credit unions

- Permits the conversion of insured credit unions to mutual savings banks or mutual savings associations without prior NCUA Board approval.

- Approval of the conversion requires the affirmative vote of a majority of credit union members who vote.

- The compensation of any director or senior management officials of a credit union that is converted to a mutual savings bank or association is limited to director fees and compensation or other benefits paid in the ordinary course of business.

Sec. 203. Limitation on member business loans

- Prohibits credit unions from making any member business loan that would result in total outstanding business loans exceeding the lesser of (1) 1.75 times the actual net worth of the credit union, or (2) 1.75 times the minimum net worth required for a well capitalized credit union, not to exceed 12.25 percent of assets [see Title III]. Credit unions currently exceeding this cap have three years to comply with these requirements.

- Exceptions to the limit are provided for credit unions: (1)chartered for the purpose of, or have a history of primarily making member business loans; (2) that predominantly serve low-income members; or (3) that are community development financial institutions. The Committee intends for the NCUA Board to interpret the exceptions to permit worthy products access to affordable financing — such as loans for agriculture, self-employment, small business establishment, large up-front investment, maintenance of equipment, or church construction.

- The report indicates that the Committee intends this section to prevent significant resources from being allocated in the future to large commercial loans that may present safety and soundness concerns.

Sec. 204. Serving persons of modest means within the field of membership of credit unions

- Reaffirms the obligation of credit unions to meet the financial services needs of persons of modest means.

- Requires the NCUA Board to prescribe criteria for periodic review of the record of each insured credit union in providing affordable credit union services to all individuals of modest means within the credit union's field of membership.

- The NCUA is also required to prescribe additional criteria for the annual evaluation of community credit unions, as well as criteria for procedures to remedy the failure of a community credit union in meeting the credit union service needs of all individuals within the credit union's field of membership.

Sec. 205. National Credit Union Administration Board Membership

- Establishes new criteria for NCUA Board appointments.

- The President, when considering appointments to the Board, is directed to consider individuals who have education, training, or experience relating to a broad range of financial services, financial services regulation, or financial policy.

Sec. 206. Report and review requirement for certain regulations

- Provides that any Board regulations defining or amending the definition of "immediate family or household" and "well-defined local community, neighborhood, or rural district" is considered a major rule for purposes of chapter 8 of title 5, United States Code.

Title III— Capitalization and Net Worth of Credit Unions

Sec. 301. Prompt and corrective action

- The goal of this section is to resolve credit union net worth deficiencies promptly, before they become more serious and before they cause losses to the National Credit Union Share Insurance Fund. (New sec. 216 of the Federal Credit Union Act)

- Modeled on a similar provision of the Federal Deposit Insurance Act, this section requires the NCUA to prescribe a prompt corrective action for federally insured credit unions, and to prescribe a system for new credit unions which shall apply in lieu of the system applicable to established federally insured unions. (FCUA sec. 216(b))

- Federally insured credit unions are classified into five categories, based on their net worth:

  - **well capitalized**: having a net worth ratio of at least 7 percent and meet any applicable risk-based net worth requirement;

  - **adequately capitalized**: having a net worth ratio of at least 6 percent and meet any applicable risk-based net worth requirement;

  - **undercapitalized**: less than 6 percent net worth or fails to meet any applicable risk-based net worth requirement;

  - **significantly undercapitalized**: has a net worth ratio of less than 4 percent, or a net worth ratio of less than 5 percent and (1) fails to submit an acceptable net worth restoration plan within the time allowed, or (2) materially fails to implement a plan accepted by the NCUA; and

- **critically undercapitalized**: less than 2 percent net worth (or not higher than 3 percent as prescribed by the NCUA). (FCUA sec. 216(c))

- These categories overlap to some degree. For example, a significantly or critically undercapitalized credit union is also an undercapitalized credit union. Therefore, rules that apply to undercapitalized credit unions would also apply to significantly or critically undercapitalized unions.

- "Complex" insured credit unions are also subject to a risk-based net worth requirement that will be prescribed by the NCUA. "Complex" is intended by the Committee to refer to credit unions' portfolios of assets and liabilities, and not a unions' field of membership. (FCUA sec. 216(d)).

- Any insured credit union that is not well capitalized must set aside as net worth not less than 0.4 percent of a credit union's total assets. This earnings retention requirement is the only prompt corrective action rule applicable to credit unions that are adequately capitalized, but not well capitalized. (FCUA sec. 216(e))

- An undercapitalized credit union must submit a timely and acceptable net worth restoration plan to the NCUA. (FCUA sec. 216(f))

- An undercapitalized insured credit union may not increase its average total assets unless (1) the NCUA has accepted the net worth restoration plan; (2) any increase in total assets is consistent with the plan; and (3) the union's net worth ratio increases at a rate consistent with the plan. An undercapitalized union is also prohibited from making new commercial loans that would result in an increase in the total amount of member business loans outstanding at that credit union. (FCUA sec. 216(g))

- In exercising its regulatory authority, the NCUA cannot treat a credit union as if it were in a lower net worth category for reasons not related to safety and soundness; and the NCUA cannot delegate its authority to treat a credit union as if it were in a lower net worth category. (FCUA sec. 216(h))

- For critically undercapitalized credit unions, the NCUA is required within 90 days to appoint a conservator or liquidating agency for the credit union, or take other action that would achieve the purposes of this section. (FCUA sec. 216(i))

- A "material loss" to the credit union insurance fund — which triggers an NCUA inspector general report— is a loss that exceeds the sum of $10 million and an amount equal to 10 percent of the credit union's total assets at the time the NCUA initiated assistance. (FCUA sec. 216(j))

- Material supervisory determinations made under FCUA sec. 216 by NCUA officials other than Board members may be appealed to the Board under an independent internal appeal process. (FCUA sec. 216(k))

- The NCUA is required to consult and work cooperatively with state credit union supervisors. (FCUA sec. 216(l))

- Insured corporate credit unions — credit unions operated primarily to serve credit unions, and in which only shareholders are permitted to be members — are exempt from section FCUA sec. 216. (FCUA sec. 216(m))

- Definitions are provided for "federal banking agency," "net worth," "net worth ratio," and "new credit union." (FCUA sec. 216(o)).

Sec. 302. National Credit Union Share Insurance Fund equity ratio, available assets ratio, and standby premium charge

- This section attempts to strengthen the Share Insurance fund in the following six ways:
  - Requires a more timely and accurate calculation of the Fund's equity ratio— the ratio of the Fund's reserves to the total shares insured.
  - Requires an insured credit union with more than $50 million in assets to adjust its 1-percent deposit in the Fund semi-annually, rather than annually.
  - Prohibits distributions from dissipating the Fund's reserves when the Fund "available-assets ratio" falls below 1 percent.
  - Gives the NCUA discretion to adjust the current fixed premium rate of 1/12 of 1 percent according to the Fund's financial needs.
  - Imposes a premium if the Fund's equity ratio falls below 1.2 percent.
  - Gives the NCUA discretion to let interest on the Fund's reserves increase the equity ratio to 1.5 percent.

Sec. 303. Access to liquidity

- Requires the NCUA to periodically assess (1) the potential liquidity needs of each insured credit union, and the options each union has available for meeting those needs; and (2) the potential liquidity needs of insured credit unions as a group, and the options those unions have available for meeting their needs.

Title IV— Miscellaneous Provisions

Sec. 401. Study and report on differing regulatory treatment

- Requires a study by the Treasury Secretary of the differences between credit unions and other federally insured financial institutions, including regulatory and tax differences. The Secretary is to report to Congress within one year.

Sec. 402. Review of regulations and paperwork reductions

- Requires each federal banking agency and the NCUA to conduct a review, and report to Congress within one year, on the regulations and written policies of each agency for the purposes of streamlining and modifying the regulations to improve efficiency, reduce unnecessary costs, and reduce paperwork burden.

Sec. 403. Treasury report on reduced taxation and viability of small banks

- Requires the Treasury Secretary to submit a second study, within a year, recommending legislative and administrative action to reduce and simplify the tax burden for insured depository institutions with less than $1 billion in assets and banks having assets of between $1 billion and $10 billion.

ADMINISTRATION POSITION

At press time, the Administration had not sent a formal Statement of Administration Position. However, the President sent a letter to the Presidents of the Credit Union National Association, Inc., and to the National Association of Federal Credit Unions commending the Banking Committee for "crafting a bipartisan compromise to resolve the uncertainty created by the Supreme Court decision." The letter also urged the Senate to pass the bill "without weighing it down with extraneous and controversial amendments." Similarly, Treasury Secretary Rubin sent a letter on July 13 to Majority Leader Lott urging "expeditious Senate passage of the bill without any extraneous amendments."

COST

The Congressional Budget Office (CBO) has estimated that H.R. 1151, as passed by the Senate, would reduce net federal outlays by $510 million from 1999 through 2003. The CBO expects that the size and number of multiple bond credit unions would grow faster than current law, resulting in increased insurance assessments. These increased insurance assessments would reduce federal outlays. However, this increased assessment income is excluded from paygo procedures.

The Joint Committee on Taxation have also estimated that enactment of H.R. 1151 would lead to a shift of deposits from financial institutions that pay federal income taxes to credit unions, which are not subject to federal income tax, resulting in revenue losses totaling $143 million from 1999 through 2003. The Banking Committee assumes these revenues would be offset by additional revenues available from passage of the IRS reform bill.

CBO found that H.R. 1151 contains intergovernmental mandates because in certain circumstances the bill would preempt state laws regulating credit unions. However, CBO estimates that they would impose only minimal costs on states.

H.R. 1151 also would impose new private-sector mandates on federally insured credit unions. CBO estimates that the direct costs of complying with those mandates is below the $100 million statutory threshold.

OTHER VIEWS

Additional Views of Senator Hagel. Senator Hagel submitted additional views expressing concern with the language addressing commercial lending by credit unions. He believes that H.R. 1151 fails "to ensure that credit unions remain strong, healthy, and committed to serving their members." In particular, he is concerned that the cap on commercial lending is too high— that if credit unions reached the cap of 1.75 times the minimum net worth— the amount would represent more commercial lending than is done by the average community bank. He is also concerned that the cap does not include loans that are less than $50,000.

Additional Views of Senators Gramm, Shelby, Mack, Faircloth, Bennett, Grams, Allard, Enzi, and Hagel. These Senators are concerned with the imposition of unfunded mandates on credit unions similar to the Community Reinvestment Act (CRA) requirements imposed on banks, and believe that these provisions should be removed. The Members are concerned that the CRA-type provisions in the bill would "ensnare credit unions in a regulatory trap from which they could only find temporary release by financing the agendas of non-members at the expense of members." Rather than imposing new mandates on credit unions, these Senators would support lifting the CRA burden from small community banks. The Senators supported an amendment to exempt community banks with less than $250 million in assets from CRA. That amendment failed by a vote of 9-9 and is expected to be addressed again on the floor.

Additional Views of Senator Enzi. The Senator believes that loans of any amount, including those of less than $50,000 should be designated as a commercial or "member business" loan if it is used 100 percent for commercial purposes.

Additional Views of Senator Reed. The Senator supports limiting commercial lending by credit unions, and is concerned that the cap in the bill is too permissive. He is concerned that the cap is significantly higher than the level of commercial lending that credit unions are currently engaged in, and he is concerned that loans under $50,000 would not count towards the cap.

POSSIBLE AMENDMENTS

Gramm.	Strikes CRA sections (section 204).
Shelby.	Exempt small banks with assets of less than $250 million from the Community Reinvestment Act.
Hagel.	Includes a truth in accounting provision and caps commercial lending at 7 percent of total assets consistent with requirement for a "well-capitalized" credit union.
Graham.	Possible amendment re: car loans.

Staff contact: Candi Wolff, 224-2946